CZAR RESOURCES LTD.

1984 Annual Report

RECD MARCH 30, 1985

Table of Contents

Czar Resources Ltd.
and Subsidiary Companies

Abbreviations

Throughout this report standard oil and gas abbreviations have been used. Their explanation is as follows:

BBLS	Barrels
MBBLS	Thousand Barrels
BOPD	Barrels of Oil Per Day
MMCF	Million Cubic Feet
MMCF/d	Million Cubic Feet Per Day
BCF	Billion Cubic Feet
psi	pounds per square inch

Annual Meeting

The Annual Meeting of Shareholders of Czar Resources Ltd. will be held on Thursday, April 18, 1985 at 3:00 p.m. in the Bel Aire Room of the Westin Hotel, Fourth Avenue and Third Street S.W., Calgary, Alberta.

PLEASE NOTE:

If you are a registered shareholder of Czar, please direct any queries regarding changes of address, loss of certificates, etc. to our transfer agent, Canada Trust Company at their Calgary office.

If you are not registered with the transfer agent and receive material from the Company directly, please send any changes of address to Czar Resources Ltd., in Calgary to the attention of the Investor Relations Department.

Czar Resources Ltd. and Subsidiary Companies

Highlights

FINANCIAL	1984	1983
Gross Revenue		
Canada	$ 13,306,559	$ 10,158,366
United States	2,363,134	2,336,043
Total	$ 15,669,693	$ 12,494,409
Cash flow (deficiency) from operations	$ 4,301,084	$ (2,420,328)
Cash flow (deficiency) per share	$ 0.37	$ (0.21)
Net earnings (loss)	$ 1,472,277	$ (19,659,808)
Net earnings (loss) per share	$ 0.13	$ (1.69)
Capital expenditures	$ 4,327,735	$ 6,230,682
Total assets	$ 96,602,670	$ 97,349,772
Common shares outstanding	11,628,553	11,628,553

OPERATING	1984	1983
Production (before royalties)		
Crude oil and natural gas liquids (BBLS)	201,477	209,161
Average daily production (BBLS/d)	551	573
Natural gas (BCF)	6.4	4.6
Average daily production (MMCF/d)	17.4	12.7
Reserves (after royalties)		
Crude oil and natural gas liquids (BBLS)		
Canada	1,080,900	1,142,500
United States	135,000	215,800
Total	1,215,900	1,358,300
Natural gas (BCF)		
Canada	279.4	271.1
United States	0.4	1.0
Total	279.8	272.1
Drilling Activity		
Gas completions	17	20
Oil completions	12	14
Dry and abandoned	4	8
Total wells	33	42
Undeveloped Land Holdings		
Net Acres		
Alberta	86,973	94,173
British Columbia	102,859	111,600
United States	—	3,256
Total	189,832	209,029

To The Shareholders

ROBERT W. LAMOND
Chairman of the Board

It is a pleasure to report on Czar's financial and operating results for fiscal 1984, primarily as the careful efforts of a number of years to improve the Company's future prospects have at last proven successful. Significantly, the Company during 1984:

- completed a debt restructuring that placed Czar in a position of long-term financial stability,
- achieved its first profit since 1980,
- reported the largest cash flow since incorporation, and
- self-financed all of its development activities.

In great measure the results were achieved through continuing efforts to keep overhead and capital costs to a minimum while working to increase revenues by developing and marketing additional blocks of Czar's large natural gas reserves. The successful expansion of the Company's gas marketing efforts during the year was a prime contributor to revenue increases and will help to maintain the Company's revenue levels in the long-term.

The year's major accomplishments in detail were:

Refinancing

The restructuring arrangement entered into by Czar and its banker, late in 1983, received a satisfactory tax ruling from Revenue Canada, and became effective on March 15, 1984. This arrangement, which resulted in the issuance of $55 million of preferred shares of a subsidiary company, will result in debt service savings of over $3 million per year during the five year term. Subsequent to the Company's year end, the dividend rate on the preferred shares, set at one half of prime plus one percent, was fixed at an effective rate of 7.35% for three years. This measure affords Czar both additional protection should interest rates trend upwards as well as improved medium-term budgeting.

Operating Results

The combination of increased revenues with lower overhead and debt service costs resulted in net earnings of $1.5 million, compared with a loss of $19.7 million in 1984. Cash flow totalled $4.3 million compared with negative cash flow of $2.4 million for the prior year. Additions to fixed assets, which totalled $6.2 million in 1983, were reduced to $4.3 million in the current year and were funded completely by internally generated cash flow. Despite Czar's leveraged position, both the improvement in operating results and long-term nature of the Company's remedial measures provide a firm base for future profitable growth.

Natural Gas Marketing

Czar continued its efforts to maintain and expand industrial gas sales, achieving record gross deliveries of 11.2 BCF during 1984. In addition to its existing Alberta sales contracts, regulatory changes in British Columbia enabled Czar to commence selling natural gas to industrial customers in that province. Relaxation of gas exporting policies by the Federal government also enabled Czar to complete a short-term export sale of British Columbia gas to a United States end-user. Deliveries have commenced under this contract, believed to be the first direct sale of its kind, and is an excellent indication of the improved marketability of the Company's British Columbia gas reserves.

Outlook

Czar is encouraged that the new Federal government's stated policies, of a less interventionist approach to business and a return of the taxation of the energy business to more realisitic levels, will substantially aid confidence in the industry's future. Although pricing of both oil and natural gas may be under some downward pressure during 1985, exacerbated by the progress of deregulation in an oversupplied market, there can be considerable optimism that production volumes, especially of natural gas, will be markedly higher.

Due to its current position of financial stability, an experienced staff and a steadily developing asset base, the Company is poised to benefit from a healthier industry climate.

I have been privileged to head the skilled staff and management team during 1984 and would like to extend to them, our directors and shareholders, my thanks for their continuing effort and support.

On behalf of the Board,

R.W. Lamond
Chairman of the Board

March 5, 1985

Financial

Balance Sheet Summary

	1984	1983
	($ Millions)	
Net current liabilities	7.5	31.1
Long-term debt	13.0	44.7
Preferred shares	55.0	—
Common shares & retained earnings	14.4	12.9

Revenues & Expenses

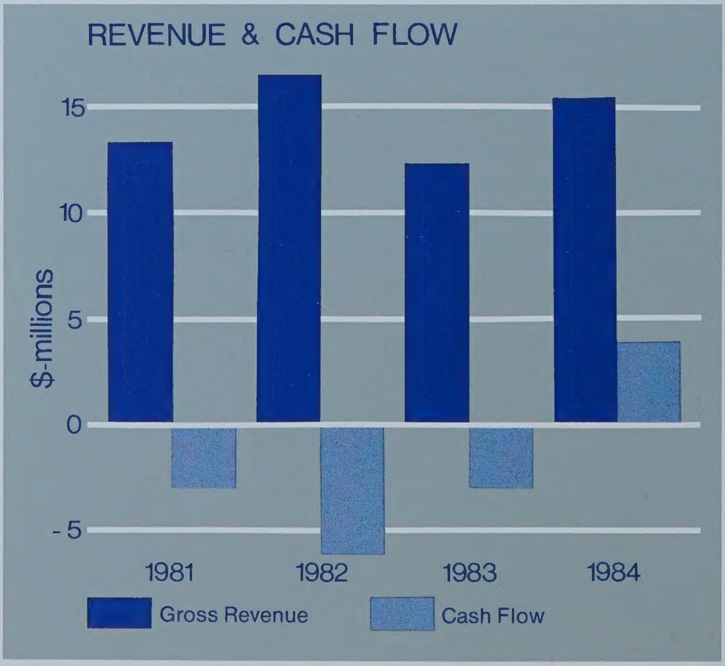
	1984	1983	1984 Change
	($ Millions)		
Revenues	15.7	12.5	3.2
Production costs	3.0	2.5	(0.5)
Administration	2.2	3.0	0.8
Bad debts (recovered)	(0.4)	1.1	1.5
Financing charges	6.6	8.3	1.7
Total expenses	11.4	14.9	3.5
Cash flow	4.3	(2.4)	6.7

The main financial priorities during 1984 were to improve the balance sheet and return the Company to a profitable position. As it was also essential not to increase overall liabilities, close financial controls on expenditures were maintained.

The Company's financial restructuring was accomplished by the issuance of $55 million of non-convertible preferred shares to the Company's banker for a like amount of long-term debt. Due to the beneficial tax treatment of dividends on these preferred shares, the Company's effective interest rate on the dividends was reduced to one half of prime plus one percent, and averaged 6½% during the last half of 1984. This refinancing resulted in a marked improvement in the Company's balance sheet in that the large current and long-term liabilities existing in 1983 were reduced to manageable levels.

For fiscal 1984, the Company's revenues, earnings and cash flow were all at near record levels. The combination of higher revenues and lower costs resulted in a cash flow turnaround of $6.7 million over the year, with cash flow increasing to $4.3 million, or $.37 per share, in 1984 versus a deficiency of $2.4 million in 1983. Had the refinancing been in effect for the entire year, cash flow would have been $1.2 million greater.

Apart from increased operating costs related to higher production volumes, all operating figures showed significant improvements. With the steady lowering of financing charges over the year, the Company's fixed charge coverage at year end was 1.6 to 1 and should improve during 1985.



An important milestone for Czar during 1984 was that its complete exploration and development budget was financed internally from cash flow. This not only resulted in no additional debt being incurred but in fact the Company's net liabilities were reduced by $0.5 million. A comparison of cash flows, fixed asset additions and increase in liabilities since 1982 shows the Company's improved operating performance and return to financial stability.

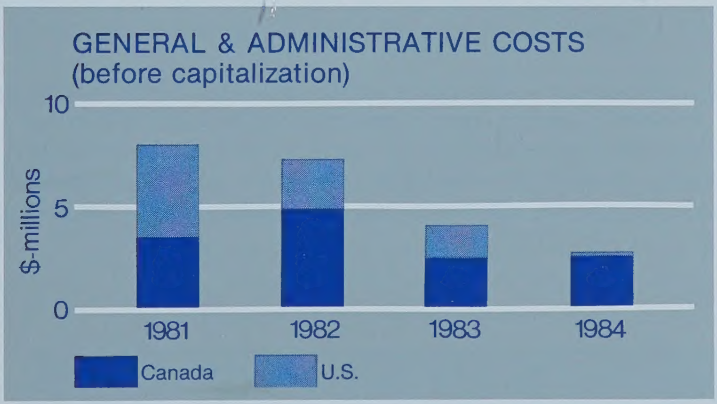
Towards the end of 1984, the Company's United States subsidiary paid off its remaining bank obligations, and is now a debt free, self-financing operation. At the end of 1984, the Board of Directors approved continuance of operations in the United States and authorized expenditures of up to U.S. $500,000 for new projects.

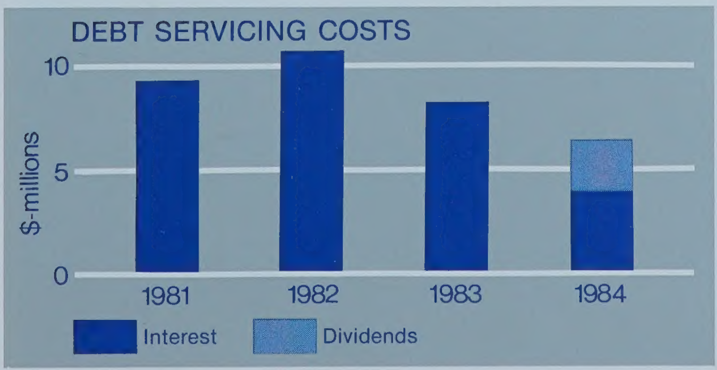
Czar's 1984 development expenditures were made exclusively in Canada and were comprised of $842,000 for production facilities, $979,000 for development drilling and $730,000 for retaining and upgrading Czar's land inventory.

With its improved financial position, the Company has raised three new blocks of European exploration funding which are being employed in a low risk development program in Southern Alberta. To date six wells have been drilled, all resulting in gaswells.

Operating Performance

	1984	1983	1982
	($ Millions)		
Cash Flow	4.3	(2.4)	(6.0)
Fixed asset additions	4.3	6.2	9.7
Increase in liabilities	—	8.6	15.7





Production

Average Product Prices

	1984	1983
Canada ($ Canadian)		
Oil - $/BBL	31.36	32.15
Gas - $/MCF	1.79	1.84
United States ($ U.S.)		
Oil - $/BBL	30.28	29.83
Gas - $/MCF	3.80	3.80

During 1984 Czar produced record volumes of natural gas, and the higher production of oil and natural gas liquids in Canada almost offset volume reductions in the United States.

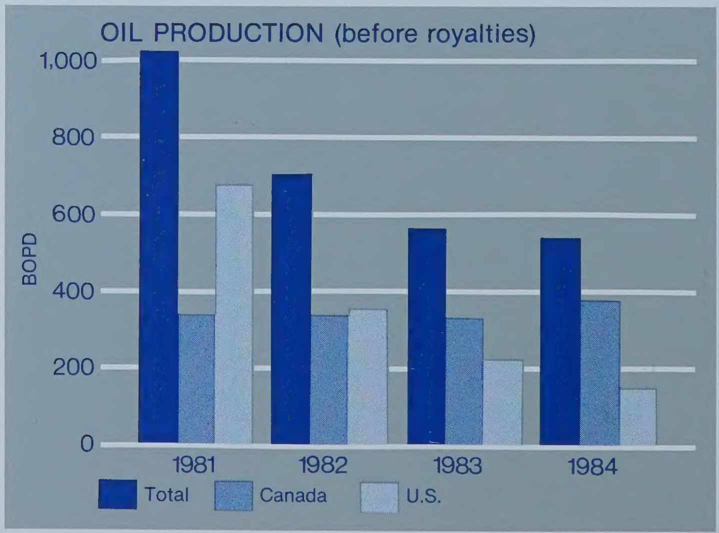
Average natural gas production, before royalties, increased from 12.7 MMCF/d in 1983 to 17.4 MMCF/d, almost a 40% increase. A major part of the increase was attributable to increased industrial gas sales during the year.

Oil and natural gas liquids production in Canada, before royalties, increased from 342 BOPD in 1983 to 388 BOPD, for an increase of 13%. While oil production remained relatively stable, gas liquids production increased due to higher gas sales.

To maintain and enlarge the Company's production capacity in British Columbia, additional gaswells were tied-in at Fireweed and Buick, and compressors were installed at Flatrock and Fireweed. In Alberta, new wells were connected at Bashaw, Erskine, Gadsby, Lowden, Kelsey and Medicine River and an additional compressor was added at Twining North.

Oil production in the United States declined from an average of 231 BOPD in 1983 to 163 BOPD, as a result of natural decline of the wells and the very limited reserve replacement effort.

Average prices received by the Company for oil and natural gas production declined slightly during 1984 and declines of a similar magnitude are expected during 1985.



Natural Gas Marketing

A priority during the year was the effort to considerably expand the marketing of Czar's shut-in natural gas reserves. This effort encompassed forming an in-house gas marketing team, developing regulatory and market information and coordinating new market opportunities with the connection of additional productive capacity.

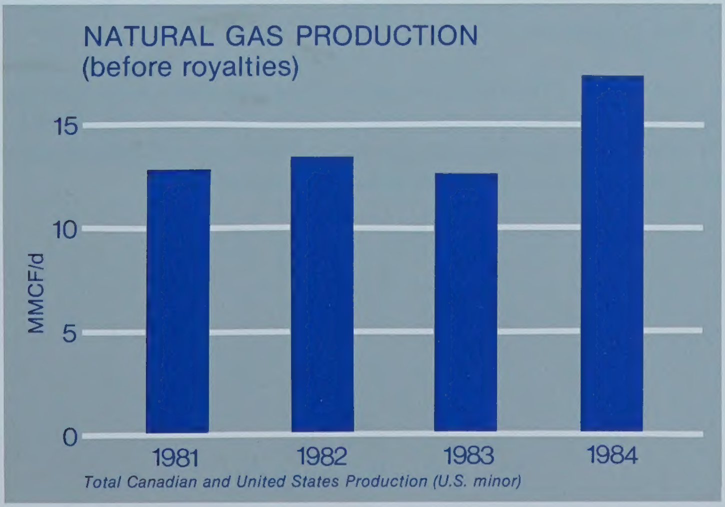
Czar commenced sales of industrial gas, at prices discounted from the prevailing rates, primarily due to the Company's requirement for incremental revenues. In addition, it quickly became apparent that the Company could more than replace its annual gas production by the reinvestment of cash flows so generated.

The prime reason behind Czar's success in the industrial gas area is that the Company was an early entrant, and thereby was positioned to benefit when the market expanded due to economic constraints.

Czar, like many other Canadian independents, developed the bulk of its gas reserves in the late 1970's at a time when full-price export contracts were not readily obtainable. Consequently, Czar in 1980 entered into one of the first large industrial gas contracts to supply a fertilizer plant in the Province of Alberta. Aided by flexible government policies, this market has expanded rapidly and Czar has become a major supplier of natural gas to the fertilizer and petrochemical industries.

With the economic recession of the early 1980's, end-users have become extremely concerned about all aspects of their manufacturing costs, including energy and feedstock. Thus Czar's sales of gas directly to end-users have met ready acceptance and have taken on a greater significance in aiding industry economics and employment levels while maintaining gas loads.

Although the direct marketing of gas by producers to end-users has at times not been favourably received by the transportation pipelines involved, it is encouraging that both the Canadian and United States regulatory authorities have specifically sanctioned direct sales as a method of helping to maximize gas price competition, retain market share and, if possible, develop incremental markets.



Industrial Gas Sales (BCF/Year)

	1984	1983
Sherritt Gordon	7.4	5.1
Alberta Gas Chemicals	1.7	1.2
Other Alberta	0.6	—
B.C. Industrial	1.5	—
Total	11.2	6.3

Gross volumes, includes Czar & Partners

A review of Czar's major industrial gas contracts follows:

In Alberta, Czar delivered 7.4 BCF or 20.2 MMCF/d to Sherritt Gordon during 1984. Czar's net share of production totalled 3.8 MMCF/d. As at November 1, 1984 an independent reserve redetermination established that Czar had developed the 153 BCF necessary to maintain full Sherritt Gordon contract volumes.

Czar also delivered 1.7 BCF or 4.7 MMCF/d to Alberta Gas Chemicals, of which Czar's net share totalled 0.9 MMCF/d, and between 2 and 5 MMCF/d to another Alberta-based end-user. By mid-1985, the Company plans to sell an additional 10 MMCF/d into the industrial gas market primarily from Gadsby and other central Alberta pools.

Perhaps the most significant events for Czar's long-term future, however, were the policy announcements on February 21, and July 13, 1984 by the British Columbia and Federal governments, respectively.

The new British Columbia government policy, designed to stimulate gas marketing, allowed producers for the first time to sell directly to end-users. The Federal government's policy change resulted in a substantial reduction in the minimum allowable prices for gas exports, and permitted even lower prices for interruptible gas sales. The combination of these regulatory changes provided Czar with the necesssary guidelines to commence an aggressive B.C. gas marketing program.

On May 7, 1984, Czar entered into an agreement to deliver industrial gas to Cominco at their plant in Trail, British Columbia. This agreement has been extended to October 1986 for volumes up to 5 MMCF/d. In addition, Czar commenced selling natural gas to the Ocelot Industries methanol plant at Kitimat, B.C. on a short-term interruptible basis.

Furthermore, the new policies opened a market of major significance to Czar in the United States Pacific Northwest, where British Columbia gas, due to its proximity to market, is very competitive. Early in 1984 Czar entered into an agreement to sell gas to the Reichhold Chemicals plant in St. Helens, Oregon, refiled an export application with the National Energy Board on July 16, 1984, and commenced delivering gas at 8 MMCF/d on December 23, 1984. The Company subsequently filed a similar application to export British Columbia gas to the Mobil Oil refinery at Ferndale, Washington. This application is presently being reviewed.

Czar is continuing its efforts to market gas wherever economic opportunities present themselves and hopes that relationships being developed with its end-users will ensure they continue to use natural gas and will contribute to the Company's production and cash flow levels in future years.

Reserves

The Company's continuing aim with regard to its reserve base has been, at minimum, to replace annual gas production volumes and begin to replace part of its oil production. In this regard, Czar was again successful during 1984 in developing net gas additions, after adjustments, of 12.3 BCF. Major additions were made in Alberta at Gadsby, Stettler, Medicine River and Nosehill Creek. Minor additions to oil reserves are attributable to new wells in Alberta at Lochend and Sylvan Lake.

The following reserve summary was prepared by Czar Resources staff by updating the prior year's independent evaluations and taking into account current production and engineering information.

Reserves Summary, Net of Royalties

	Canada		United States	
	Oil (MBBLS)	Gas (BCF)	Oil (MBBLS)	Gas (BCF)
Reserves at Oct. 31/83	1142.0	271.1	216	1.0
Additions	19.4	16.5	23	0.1
Adjustments	2.9	(3.8)	(59)	(0.5)
Production during year	(83.4)	(4.4)	(45)	(0.2)
Reserves at Oct. 31/84	1089.9	279.4	135	0.4

An analysis of Czar's Canadian gas reserves shows the sensitivity of the Company's future revenues to the marketability of its British Columbia gas. As over 72% of the Company's proven non-producing reserves and 71% of its probable reserves are located in British Columbia, it is apparent that a major effort must be maintained to put them into production. To this end a testing and evaluation program of some of the Company's more remote properties will commence in 1985, timed to the development of new market outlets.

Natural Gas Reserves (BCF), Net of Royalties

	B.C.	Alberta	Total	% B.C.
Proven producing	62.9	43.4	106.3	59.2
Proven non-producing	69.0	26.4	95.4	72.3
Probable	55.4	22.3	77.7	71.3
Total	187.3	92.1	279.4	

Exploration and Development

The Company's main exploration objective during the year was the development of shallow gas reserves in Alberta. In addition to development drilling, a number of wells were acquired and placed on stream under Czar's gas contracts and several wells were recompleted to evaluate bypassed zones.

In Canada, Czar participated directly in 15 wells, all of which were successful and resulted in 15 gaswells. In addition, 11 wells were farmed out, resulting in eight productive wells.

Due to the Company's improving financial position during the year, increasing working interests were taken in the lowest risk development drilling category and resulted in Czar retaining interests of 25% to 50% in most of the newer wells.

Of greatest significance, Czar continued to expand the limits of the Gadsby pool and to date has an interest in 13 Belly River gaswells. The pool's overall reserves, in the 100 BCF range, are of sufficient size to justify the construction of a lateral gas pipeline which is scheduled for completion by August 1985. In the vicinity of Gadsby, additional wells were drilled in the Stettler South and Ewing Lake pools.

At Medicine River, a successful offset to the Company's 14-29 well was drilled and completed as a Pekisko gaswell capable of 5.9 MMCF/d at 915 psi. A pipeline connection to the well, in which Czar owns a 22.5% working interest, is presently being constructed.

In British Columbia, Czar drilled one well b-84-J/94-P-7 in 1984 to preserve a drilling reservation at the edge of the Helmet pool. The well was completed as a Jean Marie gaswell and tested at 3.6 MMCF/d. The well, in which Czar has a 32.5% working interest, is being connected to the adjacent field gathering system.

In the United States, Czar drilled seven wells, completing the Company's obligations to prior years' drilling programs. Of the six productive wells, the most significant, Bode #3, located in the Will Rogers Airport pool in Oklahoma, commenced production in February 1984 at over 300 BOPD. To date, the well has produced 46,000 BBLS and is still producing at 50 BOPD.

Auditors' Report

To the Shareholders of
Czar Resources Ltd.

We have examined the consolidated balance sheet of Czar Resources Ltd. as at October 31, 1984 and the consolidated statements of earnings and retained earnings (deficit) and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at October 31, 1984 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada
January 18, 1985

Thorne Riddell
Chartered Accountants

Czar Resources Ltd. and Subsidiary Companies

Consolidated Balance Sheet

As at October 31, 1984

ASSETS	1984	1983
Current Assets		
Accounts receivable		
Trade	$ 6,114,590	$ 5,874,887
Drilling programs	391,377	916,821
Current portion of long-term receivables	—	117,106
Inventory of supplies, at lower of cost and net realizable value	308,620	342,700
	6,814,587	7,251,514
Long-Term Receivables	—	1,331,103
Fixed Assets		
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	101,563,491	98,328,058
Other	1,196,884	866,912
	102,760,375	99,194,970
Accumulated depletion and depreciation	12,972,292	10,427,815
	89,788,083	88,767,155
	$ 96,602,670	$ 97,349,772

Consolidated Balance Sheet

As at October 31, 1984

LIABILITIES	1984	1983
Current Liabilities		
Bank indebtedness	$ —	$ 12,333,871
Accounts payable and accrued liabilities	13,739,007	12,125,861
Current portion of long-term debt	540,000	13,936,144
	14,279,007	38,395,876
Long-Term Debt (note 3)	12,970,000	46,072,510
Preferred shares of a subsidiary company (note 2)	55,000,000	—

SHAREHOLDERS' EQUITY		
Capital Stock (notes 2 and 4)		
Authorized		
10,000,000 First preference shares with a par value of $10 each, issuable in series		
10,000,000 Second preference shares with a par value of $10 each, issuable in series		
30,000,000 Common shares without nominal or par value		
Issued		
11,628,553 Common shares	12,881,386	59,648,640
Retained Earnings (Deficit)	1,472,277	(46,767,254)
	14,353,663	12,881,386
	$ 96,602,670	$ 97,349,772

Approved by the Board:

, Director

, Director

Consolidated Statement of Earnings

Year Ended October 31, 1984

	1984	1983
Revenue		
Production	$ 15,304,204	$ 12,402,226
Less: Provincial royalties	2,031,925	1,856,248
Freehold royalties	677,398	827,021
Petroleum and gas revenue tax	737,335	564,875
Alberta royalty tax credit	(487,092)	(1,096,285)
	2,959,566	2,151,859
Net production revenue	12,344,638	10,250,367
Principal and interest from property dispositions	2,588,045	2,111,161
Processing	737,010	132,881
	15,669,693	12,494,409
Expenses		
Production	2,969,278	2,445,437
General and administrative	2,152,779	2,988,699
Bad debts (recovered)	(368,161)	1,132,651
Interest on long-term debt	4,114,822	7,325,284
Other interest	—	1,022,666
Depletion and depreciation	2,828,807	4,874,674
Write-down of petroleum and natural gas properties	—	10,744,806
	11,697,525	30,534,217
Earnings (loss) before deferred taxes, extraordinary items and preferred share dividends	3,972,168	(18,039,808)
Deferred taxes (note 5)	998,360	—
Earnings (loss) before extraordinary items and preferred share dividends	2,973,808	(18,039,808)
Extraordinary items		
Reduction of deferred taxes on application of tax costs	998,360	—
Discharge of limited partnership redemption obligation (note 3)	—	(1,620,000)
Earnings (loss) before preferred share dividends	3,972,168	(19,659,808)
Dividends on preferred shares of a subsidiary company (note 2)	2,499,891	—
Net earnings (loss)	$ 1,472,277	$(19,659,808)
Net earnings (loss) per common share (note 8)		
Earnings (loss) before extraordinary items	$0.04	$(1.55)
Net earnings (loss)	$0.13	$(1.69)

Consolidated Statement of Retained Earnings (Deficit)

Year Ended October 31, 1984

	1984	1983
Deficit at beginning of year	$(46,767,254)	$ (27,107,446)
Net earnings (loss)	1,472,277	(19,659,808)
Authorized reduction of share capital applied to deficit (note 2)	46,767,254	—
Retained earnings (deficit) at end of year	$ 1,472,277	$(46,767,254)

Consolidated Statement of Changes in Financial Position

Year Ended October 31, 1984

	1984	1983
Working Capital Derived From		
Operations	$ 4,301,084	$ —
Preferred shares of a subsidiary company	55,000,000	—
Long-term debt reclassified	12,700,000	—
Long-term receivables collection	1,331,103	841,768
Proceeds on disposal of fixed assets	478,000	606,000
Petroleum incentives	—	125,174
	73,810,187	1,572,942
Working Capital Applied to		
Operations	—	2,420,328
Long-term debt	45,262,510	2,604,174
Fixed assets	4,327,735	6,230,682
Discharge of limited partnership redemption obligations (note 3)	540,000	270,000
Long-term receivables	—	1,079,669
Current portion of long-term debt	—	7,425,029
	50,130,245	20,029,882
Increase (Decrease) in Working Capital Position	23,679,942	(18,456,940)
Working Capital Deficiency at Beginning of Year	(31,144,362)	(12,687,422)
Working Capital Deficiency at End of Year	$ (7,464,420)	$(31,144,362)

Notes to Consolidated Financial Statements

Year Ended October 31, 1984

1. Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements include the accounts of Czar Resources Ltd. and its subsidiary companies, all of which are wholly-owned.

(b) Foreign Currency Translation

The accounts of the foreign subsidiaries are translated to Canadian dollars on the following basis:

(i) monetary assets and monetary liabilities at the rate of exchange in effect as at the balance sheet date;

(ii) non-monetary assets and non-monetary liabilities at the rates of exchange in effect at the dates on which the assets were acquired or the liabilities incurred.

(iii) revenue and expenses (excluding depreciation and depletion which are translated at the same rate as the related assets) at the average rate of exchange for the year.

(iv) gains or losses resulting from such translation are charged or credited to earnings.

(c) Petroleum and Natural Gas Operations

The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized by cost center. A separate cost center is established for each country in which the Company operates, presently Canada and the United States. Costs include land acquisition costs, geological and geophysical expenditures, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, related overhead expenditures and capitalized interest related to major development projects. Costs of major development projects which require significant investment prior to determination of the quantities of proved reserves are excluded from the depletion calculation until the quantities of proved reserves are determined. Costs are depleted by cost center using the composite unit of production method based upon estimated proved developed reserves. In calculating depletion, crude oil reserves are converted to equivalent units of natural gas based on the relative net sales value of each product.

Under certain drilling programs, a significant portion of the consideration for the sale of properties by the Company to limited partnerships is payable to the Company by instalments over periods of 35 or 39 years, depending on the partnership. Principal and interest payments, in the aggregate, may not exceed a fixed percentage of net revenue from the wells drilled. Unpaid principal instalments total $46,816,510 at October 31, 1984 (1983 - $48,111,311). Such principal and interest payments are recorded as and when received.

All of the Company's exploration and development activities related to petroleum and natural gas are conducted with others; the Company records only its proportionate interest in such activities.

(d) Depreciation

Depreciation of petroleum and natural gas production equipment and related facilities is provided on the composite unit of production method based on estimated proved developed reserves of each cost center. Depreciation of other equipment is provided on a straight-line basis at rates which are estimated to amortize the cost of the assets over their useful lives.

Notes to Consolidated Financial Statements
Year Ended October 31, 1984

2. Financial Reorganization

In 1984, the Company negotiated a refinancing of its indebtedness with its banker, the Toronto-Dominion Bank, and successfully completed a financial reorganization.

On May 15, 1984, a wholly-owned subsidiary, Czar Financing Alberta Ltd. issued to the Company's banker, $55,000,000 of cumulative, redeemable, non-voting first preferred shares. The proceeds of the issue were borrowed by Czar Resources Ltd. ("Czar") from its subsidiary and were used to reduce its long-term bank loan. Czar has the obligation, on or before the last day of February in each year, commencing on February 28, 1985, to repay amounts borrowed from its subsidiary, such repayment amounts to be Czar's defined "Excess Cash Flow", less $200,000, as determined for Czar's immediately preceding fiscal year. The subsidiary in turn, is obliged to use such funds to redeem its preferred shares by February 28, each year. All the preferred shares must be redeemed on or before March 15, 1989 from additional bank borrowings or alternate financing. No repayment of Czar's indebtedness to its subsidiary and redemption of preferred shares will be required on February 28, 1985 because "Excess Cash Flow" in respect of Czar's fiscal year ended October 31, 1984 is insufficient to require such repayment and redemption.

Upon certain events of default, the Bank has the right to sell the preferred shares to Czar. In the event Czar is unable to consummate the purchase, the bank may assert its rights under a floating charge debenture on all the assets of Czar and assignments of accounts receivable and certain petroleum and natural gas properties and revenue interests therein. The Company has agreed with the bank that it will not encumber any of its assets or dispose of any of its petroleum and natural gas properties, other than to its joint venture participants in the normal course of business, without, in each case, the consent of the bank.

Dividends on the preferred shares are payable quarterly on the last day of March, June, September and December at the rate of one-half bank prime for such quarter plus 1%. Czar is required to make contributions to its subsidiary sufficient to pay these dividends.

In the five year term of the preferred shares, the Bank will receive warrants to purchase 1,162,855 common shares of the Company. As at October 31, 1984 the Bank has received 465,142 warrants (see Note 4 (c)) and will receive 232,571 warrants in each of the 1985, 1986 and 1987 fiscal years. The warrants will be exercisable for a period of five years at the closing market price of the common shares at the dates on which the warrants are issued.

The Company also negotiated a revolving line of credit of $16.5 million with its banker. Loans under this line of credit bear interest at prime plus ¼%. A further non-interest bearing loan of $2.5 million was negotiated to cover accrued but unpaid interest on the previous bank loans. The bank loans are evidenced by notes payable on demand to the bank and are secured by the floating charge debenture and other security described above.

At the special and annual general meeting of the Shareholders held on April 18, 1984 the shareholders authorized:

a) continuance of the Company under the Business Corporations Act (Alberta).

b) the increase of the authorized share capital of the Company to 30 million common shares without nominal or par value, 10 million First Preference Shares with a par value of $10, and 10 million Second Preference Shares with a par value of $10.

c) the reduction of the capital reserve fund by $145,500 which was applied against the deficit, thereby reducing the deficit to $46,767,254.

d) the reduction of the common share capital by $46,767,254, being the amount of the deficit after reduction of the capital redemption reserve fund.

Reference is made to notes 3 and 4.

Notes to Consolidated Financial Statements

Year Ended October 31, 1984

3. Long-Term Debt

	1984	1983
Bank loan, bearing interest at prime plus ¼%	**$10,200,000**	$ —
Bank loan, non-interest bearing	**2,500,000**	—
Amounts payable pursuant to the discharge of limited partnership redemption obligations, non-interest bearing	**810,000**	1,350,000
Bank loan, bearing interest at prime plus ¾%	—	55,000,000
Bank loan, bearing interest at U.S. base plus ¾%	—	3,658,654
	13,510,000	60,008,654
Less current portion	**540,000**	13,936,144
	$12,970,000	$46,072,510

The bank loans are repayable out of future production proceeds and the proceeds from any sales of oil and gas properties and are not expected to require the use of existing working capital.

Reference is made to note 2.

The Company had entered into joint venture agreements with a number of limited partnerships for the exploration and development of properties. The limited partnerships were required annually to redeem units of the limited partnerships. To ensure that the limited partnerships had the financial ability to make such redemptions, the Company was required annually to acquire certain of the limited partnerships' interests. In 1983 a company indirectly controlled by the president of the Company purchased all of the outstanding units of the limited partnerships and thereafter dissolved the partnerships. In consideration for the discharge of the obligation to purchase interests in the assets of the partnerships, the Company agreed to make monthly payments of $45,000 for 36 months beginning in May 1983.

4. Capital Stock

(a) Authorized

Reference is made to note 2.

(b) Options

At October 31, 1984 directors, officers and employees held options to purchase 921,700 common shares of the Company at prices ranging from $1.50 to $1.70 per share exercisable from time to time to July, 1989.

(c) Share Purchase Warrants

At October 31, 1984 1,065,142 common share purchase warrants were outstanding, entitling the holders of 600,000 warrants to purchase one common share at the price of $17.00 on or before April 30, 1986; and entitling the Company's banker, the holder of 465,142 warrants, to purchase 232,571 common shares at $1.86, on or before May 15, 1989 and 232,571 common shares at $1.60, on or before October 31, 1989.

5. Income Taxes

The Company has losses for Canadian tax purposes of approximately $3.1 million, the benefit of which has not been reflected in the accounts. The losses expire commencing in 1987.

The deferred income tax provision does not include any provision with respect to the Company's United States subsidiary as there are sufficient unrecorded tax losses available to offset future earnings for a number of years.

6. Segmented Information

The Company has a single line of business, which is the exploration for and the development and production of petroleum and natural gas. Information about the Company's operations by geographic segment is as follows:

Notes to Consolidated Financial Statements

Year Ended October 31, 1984

	Year Ended October 31, 1984		
	Canada	U.S.A.	Total
Identifiable assets	$ 94,055,738	$ 2,546,932	$ 96,602,670
Net production revenue	9,981,504	2,363,134	12,344,638
Principal and interest from property dispositions	2,588,045	—	2,588,045
Processing revenue	737,010	—	737,010
	13,306,559	2,363,134	15,669,693
Less:			
Production expense	2,682,743	286,535	2,969,278
Depletion and depreciation	2,828,807	—	2,828,807
Operating profit	7,795,009	2,076,599	9,871,608
General and administrative expenses	1,692,593	460,186	2,152,779
Bad debts (recovered)	—	(368,161)	(368,161)
Interest expense	3,905,616	209,206	4,114,822
	5,598,209	301,231	5,899,440
Earnings before deferred taxes, extraordinary item and preferred share dividends	2,196,800	1,775,368	3,972,168
Deferred taxes	998,360	—	998,360
Earnings before extraordinary item and preferred share dividends	1,198,440	1,775,368	2,973,808
Extraordinary item	998,360	—	998,360
Earnings before preferred share dividends	2,196,800	1,775,368	3,972,168
Dividends on preferred shares of a subsidiary company	2,499,891	—	2,499,891
Net earnings (loss)	$ (303,091)	$ 1,775,368	$ 1,472,277

	Year Ended October 31, 1983		
	Canada	U.S.A.	Total
Identifiable assets	$92,907,445	$ 4,442,327	$ 97,349,772
Net production revenue	7,914,324	2,336,043	10,250,367
Principal and interest from property dispositions	2,111,161	—	2,111,161
Processing revenue	132,881	—	132,881
	10,158,366	2,336,043	12,494,409
Less:			
Production expense	1,822,834	622,603	2,445,437
Depletion and depreciation	2,689,619	2,185,055	4,874,674
Operating profit (loss)	5,645,913	(471,615)	5,174,298
General and administrative expenses	1,420,872	1,567,827	2,988,699
Bad debts	—	1,132,651	1,132,651
Interest expense	7,805,959	541,991	8,347,950
Write-down of petroleum and natural gas properties	—	10,744,806	10,744,806
	9,226,831	13,987,275	23,214,106
Loss before extraordinary item	(3,580,918)	(14,458,890)	(18,039,808)
Extraordinary item	1,620,000	—	1,620,000
Loss for the year	$ (5,200,918)	$(14,458,890)	$ (19,659,808)

Notes to Consolidated Financial Statements
Year Ended October 31, 1984

7. Related Party Transactions

A significant shareholder, director and senior officer of the Company is a majority shareholder of a corporation which is the general partner of certain limited partnerships and the manager of certain other companies which have entered into joint ventures with the Company for the exploration and development of properties. At October 31, 1984 the said limited partnerships and companies were indebted to the Company in the aggregate amount of $391,377 (1983 - $2,113,596). In the year ended October 31, 1984 the charges made by the Company to such limited partnerships and companies totalled $3,188,887 (1983 - $3,868,722).

8. Earnings Per Common Share

Net earnings per common share is calculated using the average number of common shares outstanding during the year of 11,628,553. Earnings per common share is calculated after deduction of dividends on preferred shares of a subsidiary company.

9. Comparative Figures

Certain 1983 comparative figures have been reclassified to conform with the financial statement presentation adopted for 1984.

Corporate Information

Board of Directors and Officers Czar Resources Ltd.

Robert W. Lamond, Director
Chairman of the Board
& Chief Executive Officer
Calgary, Alberta

Bonita O. Rawlyck, Director
Senior Vice President, Finance
& Chief Financial Officer
Calgary, Alberta

Brian C. Bentz, Director
Vancouver, British Columbia

Charles A. Teare, Director
Calgary, Alberta

Allan R. Twa
Corporate Secretary
Calgary, Alberta

Key Personnel

P. Richard Ewacha
Engineering Manager

Sharon P. Runge
Land Manager

Herbert J. Visscher
Exploration Manager

Paul M. Boechler
Controller

Donald K. Clark
Engineering Superintendent,
British Columbia

Philip W. Payzant
Engineering Superintendent,
Alberta

Officers of Czar Resources Inc., U.S. Subsidiary

John A. Habbishaw
Vice President and
General Manager

Thomas L. Kent
Vice President and
Treasurer

T. William Porter
Corporate Secretary

Corporate Office

Suite 700, 425 First Street S.W.
Calgary, Alberta T2P 3L8
(403) 265-0270 Telex 03-826735

Czar Resources Ltd.
and Subsidiary Companies

U.S. Office

333 North Belt, Suite 390
Houston, Texas 77060
(713) 931-6634 Telex 790219

Division and Field Office

P.O. Box 6718
Fort St. John,
British Columbia V1J 4J4
(604) 787-7718

Legal Counsel

Burnet, Duckworth & Palmer
32nd Floor, 425 First Street S.W.
Calgary, Alberta T2P 3L8

Porter & Clements
3500 Republic Bank Center
Houston, Texas 77002

Auditors

Thorne Riddell
1400, 205 Fifth Avenue S.W.
Calgary, Alberta T2P 2W4

Main Hurdman
4200 Capital Bank Plaza
Houston, Texas 77002

Registrar & Transfer Agents

The Canada Trust Company
505 Third Street S.W.
Calgary, Alberta T2P 3E6

Wholly-Owned Subsidiaries

Czar Resources Inc.
Czar Financing Alberta Ltd.

Stock Listings

The Toronto Stock Exchange

The Alberta Stock Exchange

The Montreal Stock Exchange

Trading Symbol — CZR

CZAR RESOURCES LTD.

PRINTED IN CANADA
BY STYLECRAFT PRINTING

Oil production in the United States increased to 122 barrels of oil per day (BOPD) from 98 BOPD in the first quarter. However, continued natural well declines resulted in production rates for the first six months which were sharply reduced from those of 1983.

First half production rates net to Czar, after royalties, were:

	FIRST HALF 1984		FIRST HALF 1983	
	BOPD	MMCF/d	BOPD	MMCF/d
Canada	267	12.7	345	9.0
United States	122	0.4	217	0.4
TOTAL	389	13.1	562	9.4

Gross production of natural gas to Sherritt Gordon Mines Ltd. and Alberta Gas Chemicals averaged 22.5 million and 3.5 million cubic feet per day (MMCF/d) respectively.

The British Columbia government's announcement of February 21, 1984, providing incentives to the petrochemical industry, enabled Czar to conclude a short-term contract to supply gas to a Cominco Ltd. plant at Trail, B.C. The contract provides for the delivery of seven million cubic feet of gas per day, for a five month term, with provisions for extension. Production commenced May 8, 1984, with Czar holding an average 42% working interest in the contracted wells.

The Company's gas export application, to provide British Columbia gas to a Reichhold Chemicals plant at St. Helens, Oregon is still pending approval by the necessary regulatory bodies. Czar is encouraged however, that recent statements by federal and provincial authorities recommending buyer-seller negotiations, contract flexibility and most important, lower gas pricing for incremental markets could result in the approval of Czar's application by October of 1984. Other marketing opportunities for the Company's large block of B.C. gas are being vigorously pursued.

EXPLORATION & DEVELOPMENT

During the first six months, the Company participated in the drilling of 20 wells in Canada and the United States of which eight were drilled by way of farmout at no cost to the Company.

SUMMARY OF WELLS DRILLED OR PARTICIPATED IN DURING THE SIX MONTHS ENDED APRIL 30, 1984

	Gas	Oil	Dry	Total
Canada	8	4	4	16
United States	1	2	1	4
TOTAL	9	6	5	20

Three additional development wells were drilled in the Gadsby pool of central Alberta, bringing to ten the number of successful Belly River gas wells in that pool. A development well, drilled to hold a large block of leases in the Petitot field of northeastern B.C. resulted in a potential Jean Marie gaswell. The Company further developed a pool in the United States in the Will Rogers Airport area in Oklahoma with the Bode #4 well, while the offsetting Bode #3 is currently flowing at a rate of 138 BOPD and 180 MCF/d from a thick Skinner sand section.

R.W. Lamond,
Chairman of the Board

June 15, 1984

N CANADA

CZAR RESOURCES LTD.
Suite 700, 425 First Street S.W.
Calgary, Alberta T2P 3L8

Mrs. Martin Lynch
Box 1269
KASLO, B.C.
VOG 1MO

CALGARY 28 VI 1984 ALBERTA

CANADA POSTAGE 00.32

CZAR RESOURCES LTD.

INTERIM REPORT TO SHAREHOLDERS

6 MONTHS ENDED APRIL 30, 1984

CZAR RESOURCES LTD.
AND SUBSIDIARY COMPANIES

TO THE SHAREHOLDERS

On behalf of the Board of Directors, I am pleased to report that Czar's financial and operating results for the six months ended April 30, 1984 show a significant improvement in the Company's position, aided considerably by the completion, effective March 15, 1984 of a major refinancing with the Company's banker.

The Company, after a number of difficult years, has now been returned to a stable financial position and will be able, with its own cash flows, to both develop its substantial asset base and pay down some of its currently outstanding debt.

Czar has been successful in its continuing efforts to find industrial markets for its British Columbia gas reserves, and has contracted and placed on stream the first sizable block of gas sold under the British Columbia government's new petrochemical incentive program.

FINANCIAL

During the first six months of fiscal 1984, gross revenues increased 17% to $8,766,110 from $7,472,587 for the same period in 1983. Net earnings totalled $1,572,583 compared with a 1983 loss of $2,299,066. Cash flow from operations increased to $2,896,654 or $0.25 per share from $102,878 or $.01 per share.

Increased cash flow resulted from higher gas production revenue due to a colder winter, processing charges to users of the Company's gas plants, as well as markedly reduced production, overhead and interest expenses.

Subsequent to April 30, 1984 the Company and its banker closed a refinancing arrangement whereby the Company issued preferred shares to the bank in the amount of $55 million, proceeds of which repaid a like amount of long-term debt. The preferred shares pay dividends at an annual rate of one half of prime plus 1%. As the arrangement was effective March 15, 1984, the financial statements reflect reduced interest charges for a portion of the period.

The Company, in addition, has drawn down $8.9 million of a $16.5 million line of credit. This credit, for Canadian expenditures, bears interest at prime plus ¼% and will be repaid from future production proceeds. The Company's United States term loan of $2.2 million (U.S.) is being repaid in quarterly installments of $393,000 (U.S.)

At Czar's extraordinary and annual meeting of shareholders on April 18, 1984, the shareholders approved a reduction of the paid up capital to the extent of $46,767,254 which was the amount of the Company's deficit at October 31, 1983. The deficit was thereby eliminated, and at April 30, 1984 the Company's retained earnings were $1,572,583.

PRODUCTION

Czar's Canadian gas production increased from 1983 due to a more severe winter and production in February and March continued to exceed the Company's budget due to the cold spring weather. The reduction of Czar's net Canadian oil production resulted from a number of oil wells reaching payout, thereby lowering the Company's interest.

CZAR RESOURCES LTD.
CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS (DEFICIT) SIX MONTHS ENDED APRIL 30, 1984
(Unaudited)

	1984	1983
REVENUE		
Production	$ 8,701,175	$ 7,462,195
Less: Provincial royalties	1,649,348	1,120,763
Freehold royalties	449,480	445,220
Petroleum and gas revenue tax	384,042	190,496
Alberta royalty tax credit	(516,395)	(566,604)
	1,966,475	1,189,875
Net production revenue	6,734,700	6,272,320
Principal and interest from property dispositions	1,473,985	1,200,267
Processing	557,425	—
	8,766,110	7,472,587
EXPENSES		
Production	1,069,273	1,432,441
General and administrative	1,127,402	1,653,619
Interest on long-term debt	2,520,616	4,266,205
Other interest	686,925	17,444
Provision for dividends on preferred shares of a subsidiary company	465,240	—
	5,869,456	7,369,709
FUNDS DERIVED FROM OPERATIONS	2,896,654	102,878
CHARGES NOT REQUIRING FUNDS		
Depletion and depreciation	1,324,071	2,401,944
NET EARNINGS (LOSS) FOR THE PERIOD	1,572,583	(2,299,066)
DEFICIT AT BEGINNING OF PERIOD	(46,767,254)	(27,107,443)
Application to deficit on authorized reduction of share capital	46,767,254	—
RETAINED EARNINGS (DEFICIT) AT END OF PERIOD	$ 1,572,583	$(29,406,509)
NET EARNINGS (LOSS) PER SHARE	$ .14	$ (.20)
FULLY DILUTED EARNINGS (LOSS) PER SHARE	$ .13	$ (.20)

CZAR RESOURCES LTD.
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION SIX MONTHS ENDED APRIL 30, 1984
(Unaudited)

	1984	1983
WORKING CAPITAL DERIVED FROM		
Operations	$ 2,896,654	$ 102,878
Preferred shares of a subsidiary company	55,000,000	—
Long-term debt	21,954,072	—
Long-term receivables	75,346	366,547
	79,926,072	469,425
WORKING CAPITAL APPLIED TO		
Repayment of long-term debt	55,000,000	950,215
Additions to fixed assets	1,552,035	2,554,677
Discharge of limited partnership redemption obligations	270,000	—
Current portion of long-term debt	—	4,168,379
	56,822,035	7,673,271
INCREASE (DECREASE) IN WORKING CAPITAL POSITION	23,104,037	(7,203,846)
WORKING CAPITAL DEFICIENCY AT BEGINNING OF PERIOD	(31,144,362)	(12,687,422)
WORKING CAPITAL DEFICIENCY AT END OF PERIOD	$ (8,040,325)	$(19,891,268)